

9 October 2023

*To the Independent Board Committee and
the Independent Shareholders of
CSPC Pharmaceutical Group Limited*

Dear Sir/Madam,

**GRANT OF SHARE OPTIONS UNDER THE SHARE OPTION SCHEME
AND
APPLICATION FOR WHITEWASH WAIVER**

INTRODUCTION

We refer to our appointment as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Underlying Transaction, the Whitewash Waiver and the transactions contemplated thereunder, the details of which are set out in the Letter from the Board (the “**Board Letter**”) in the circular dated 9 October 2023 issued by the Company to the Shareholders (the “**Circular**”), of which this letter forms part. Terms used in this letter shall have the same meanings as defined in the Circular unless the context requires otherwise.

Conditional grant of Share Options under the Share Option Scheme

On 4 September 2023, the Company has conditionally granted the Share Options to the Management Grantees to subscribe for an aggregate of 50,000,000 Shares under the Share Option Scheme at the exercise price of HK\$5.98 per Share, subject to acceptances by the Management Grantees after the Grant Conditions have been fulfilled.

Application for Whitewash Waiver

As at the Latest Practicable Date, the Management Group held an aggregate of 3,558,899,663 Shares, representing approximately 29.90% of the total number of issued Shares as at the Latest Practicable Date. Upon completion of the Exercise of the Share Options, the Management Group will be interested in 3,608,899,663 Shares, representing (a) approximately 30.32% of the total number of issued Shares as at the Latest Practicable Date; and (b) approximately 30.19% of the total number of issued Shares as enlarged by the issuance of the Share Option Shares.

The Exercise of the Share Options in full will cause the aggregate shareholding interests in the total number of issued Shares held by the Management Group to increase from approximately 29.90% (of the total number of issued Shares as at the Latest Practicable Date) to approximately 30.19% (of the total number of issued Shares as enlarged by the issuance of the Share Option Shares). Accordingly, the Management Grantees would be obliged to make a mandatory general offer pursuant to Rule 26.1 of the Takeovers Code to the Shareholders for all the issued Shares of the Company not already owned or agreed to be acquired by the Management Group if their aggregate shareholding interests in the Group is increased to 30.0% or more of the total number of issued Shares as a result of the allotment and issuance of the Share Option Shares to the Management Grantees, unless the Whitewash Waiver is granted by the Executive.

In this regard, an application has been made to the Executive for the Whitewash Waiver pursuant to Note 1 on dispensations from Rule 26 of the Takeovers Code. The Whitewash Waiver, if granted by the Executive, will be subject to, among other things, the conditions that the respective resolutions relating to the Underlying Transaction on the one hand, and the Whitewash Waiver on the other hand, being approved by more than 50% and at least 75% respectively, of the votes cast by the Independent Shareholders at the EGM by way of poll in accordance with the requirements of the Takeovers Code.

The Executive has agreed, subject to the respective resolutions relating to the Underlying Transaction on the one hand, and the Whitewash Waiver on the other hand, being approved by more than 50% and at least 75% respectively, of the votes cast by the Independent Shareholders at the EGM by way of poll, to waive the obligation of the Management Grantees to make a mandatory general offer as a result of the allotment and issuance of the Share Options Shares to the Management Grantees by the Company.

The EGM will be held to approve, among other things, Mr. Cai's Share Options, the Underlying Transaction and Whitewash Waiver by way of poll.

In respect of Mr. Cai's Share Options, (a) Mr. Cai and Mr. Cai's Related Persons which held 2,830,103,350 Shares in aggregate (representing approximately 23.78% of the issued Shares) as at the Latest Practicable Date; and (b) the Trustee which held 51,464,000 Shares under the Share Award Scheme (representing approximately 0.43% of the issued Shares) as at the Latest Practicable Date shall abstain from voting in respect of the relevant resolution at the EGM.

In respect of the Underlying Transaction and Whitewash Waiver, (a) the Management Group, who held an aggregate of approximately 29.90% of the total issued Shares as at the Latest Practicable Date, and any other Shareholders who are involved in or interested in the Underlying Transaction and the Whitewash Waiver shall abstain from voting in respect of the relevant resolutions at the EGM; and (b) the Trustee will not exercise any voting rights in respect of any Shares held by it under the Share Award Scheme, and as such, the Trustee shall also abstain from voting in respect of the relevant resolutions at the EGM.

As Mr. Cai, Mr. ZHANG Cuilong, Dr. LI Chunlei, Mr. WANG Huaiyu, Mr. WANG Zhenguo, Mr. PAN Weidong, Dr. WANG Qingxi, Mr. CHAK Kin Man and Dr. JIANG Hao have material interests in the Underlying Transaction and/or the Whitewash Waiver, each of them has abstained from voting on the Board resolutions for approving the Underlying Transaction and the Whitewash Waiver. Save as the aforesaid, no other Director has any material interest in the Underlying Transaction and/or the Whitewash Waiver and therefore was required to abstain from voting on the Board resolution approving the Underlying Transaction and Whitewash Waiver.

The Independent Board Committee, comprising all the independent non-executive Directors, namely Mr. WANG Bo, Mr. CHEN Chuan, Prof. WANG Hongguang, Mr. AU Chun Kwok Alan, Mr. LAW Cheuk Kin Stephen and Ms. LI Quan, in compliance with Rule 2.8 of the Takeovers Code, has been formed to advise the Independent Shareholders on the Underlying Transaction, the Whitewash Waiver and the transactions contemplated thereunder. We, Nuada Limited, have been appointed by the Board with the approval of the Independent Board Committee as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in this regard.

We, Nuada Limited, do not have any previous financial adviser and/or independent financial adviser engagement with the Company in the past two years. We are independent from, and are not associated or connected with the Company, the Management Grantees or any party acting, or presumed to be acting, in concert with any of the above, or any company controlled by any of them. Apart from normal professional fees payable to us in connection with this appointment as the independent financial adviser to the Independent Board Committee and the Independent Shareholders, no arrangement exists whereby we will receive any fees or benefits from the abovementioned parties or any party acting, or presumed to be acting, in concert with any of them, any of their respective associates, close associates or core connected persons or other parties that could be regarded as relevant to our independence. Accordingly, we consider that we are independent pursuant to Rule 2 of the Takeovers Code and Rule 13.84 of the Listing Rules to act as the Independent Financial Adviser to give independent advice in respect of the Underlying Transaction, the Whitewash Waiver and the transactions contemplated thereunder to the Independent Board Committee and the Independent Shareholders in accordance with the Takeovers Code.

BASIS OF OUR OPINION

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have relied on the statements, information, opinions and representations contained or referred to in the Circular and the representations made to us by the Directors and the management of the Company (the “**Management**”). We have assumed that all statements, information and representations provided by the Directors and the Management, for which they are solely responsible, are true and accurate at the time when they were provided and continue to be so as at the Latest Practicable Date and the Independent Shareholders will be notified of any material changes to such statements, information, opinions and/or representations as soon as possible in accordance with Rule 9.1 of the Takeovers Code. We have also assumed that all statements of belief, opinion, expectation and intention made by the Directors in the Circular were reasonably made after due enquiry and careful consideration. We have no reason to suspect that any material facts or information have been withheld or to doubt the truth, accuracy and completeness of the information and facts contained in the Circular, or the reasonableness of the opinions expressed by the Company, its advisers and/or the Directors, which have been provided to us.

The Circular includes particulars given in compliance with the Listing Rules and the Takeovers Code for the purpose of giving information with regard to the Underlying Transaction, the Whitewash Waiver and the transactions contemplated thereunder and the Group. The Directors jointly and severally accept full responsibility for the accuracy of the information contained in the Circular and confirm, having made all reasonable inquiries, that to the best of their knowledge, opinions expressed in the Circular have been arrived at after due and careful consideration and there are no other facts not contained in the Circular, the omission of which would make any statement in the Circular misleading.

Our review and analysis were based upon, among other things, (i) the Announcement; (ii) the Circular; (iii) the annual report of the Company (“**Annual Report 2020**”) for the financial year ended 31 December 2020 (“**FY2020**”); (iv) the annual report of the Company (“**Annual Report 2021**”) for the financial year ended 31 December 2021 (“**FY2021**”); (v) the annual report of the Company (“**Annual Report 2022**”) for the financial year ended 31 December 2022 (“**FY2022**”); and (vi) the interim report of the Company (“**Interim Report 2023**”) for the six months ended 30 June 2023 (“**FP2023**”).

We consider that we have been provided with sufficient information and have taken sufficient and necessary steps on which to form a reasonable basis and an informed view for our opinion in compliance with the requirements of the Takeovers Code and Rule 13.80 of the Listing Rules. We have not, however, carried out any independent verification of the information provided, nor have we conducted any independent investigation into the business and affairs of the Group. We have not considered the taxation implication on the Group or the Independent Shareholders as a result of the Underlying Transaction, the Whitewash Waiver and the transactions contemplated thereunder. Our opinion is necessarily based on the financial, economic, market and other conditions in effect and the information made available to us as at the Latest Practicable Date. Where information in this letter has been extracted from published or otherwise publicly available sources, the sole responsibility of us is to ensure that such information has been correctly and fairly extracted, reproduced or presented from the relevant stated sources and not be used out of context.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion and recommendation with regard to the Underlying Transaction, the Whitewash Waiver and the transactions contemplated thereunder, we have taken into account the following principal factors and reasons:

1. Background information of the Group

(a) *Principal business of the Group*

With reference to the Board Letter and according to the Management, the Group is principally engaged in the manufacture and sale of pharmaceutical products in the PRC and the Group's reportable segments are as follows:

- (i). Finished drugs ("**Finished Drug Business**") — research and development, manufacture and sale of pharmaceutical products and license fee income;
- (ii). Bulk products ("**Bulk Product Business**") — manufacture and sale of vitamin C and antibiotic products in bulk powder form; and
- (iii). Functional food and others — manufacture and sale of functional food products (including caffeine food additives and vitamin C buccal tablets), and provision of healthcare service and others.

(b) *Financial information of the Group*

Set out below is a summary of the Group's operating results and financial position extracted from the Company's Annual Report 2020, Annual Report 2021, Annual Report 2022 and Interim Report 2023.

Table 1: Consolidated income statement of the Group

	For the six months ended 30 June		For the year ended 31 December		
	2023	2022	2022	2021	2020
	RMB'000 (unaudited)	RMB'000 (unaudited)	RMB'000 (audited)	RMB'000 (audited)	RMB'000 (audited)
Revenue	16,080,412	15,610,026	30,936,904	27,866,870	24,942,204
Finished drugs	12,933,714	12,292,908	24,520,067	22,681,444	20,404,678
Bulk products	1,969,817	2,180,074	4,450,936	3,819,209	3,231,911
Functional food and others	1,176,881	1,137,044	1,965,901	1,366,217	1,305,615
Gross profit	11,237,639	11,338,484	22,256,414	21,135,094	18,685,322
Selling and distribution expenses	(4,902,391)	(5,410,159)	(10,337,423)	(10,443,422)	(9,377,620)
Administrative expenses	(535,640)	(564,819)	(1,172,842)	(1,009,824)	(945,713)
Research and development expenses	(2,303,611)	(1,884,077)	(3,986,516)	(3,432,590)	(2,889,837)
Profit before tax	3,681,554	3,719,460	7,582,261	6,847,096	6,391,023
Profit for the year/ period	3,058,040	3,027,083	6,232,050	5,688,124	5,229,010
Profit for the year/ period attributable to owners of the Company	2,966,987	2,966,205	6,091,390	5,605,185	5,159,655

Financial performance for FY2020

The Group recorded a revenue of approximately RMB24.94 billion for FY2020, which represented an increase of approximately 12.85% as compared with that of approximately RMB22.10 billion for the financial year ended 31 December 2019 (“FY2019”). According to the Annual Report 2020 and the Management, Finished Drug Business was the major growth driver to the Group with revenue increasing by approximately 13.71%, from approximately RMB17.94 billion for FY2019 to approximately RMB20.40 billion for FY2020 mainly due to growth in sales volume of certain finished drug products including drugs for the therapeutic areas of oncology and nervous system. Having benefited from the growth of the revenue, the gross profit also increased from approximately RMB15.91 billion for FY2019 to approximately RMB18.69 billion for FY2020, which represented an increase of approximately 17.47% and the gross profit margin remained stable and recorded approximately 74.91% for FY2020 as compared to that of approximately 71.98% for FY2019.

The selling and distribution expenses of the Group increased from approximately RMB8.71 billion for FY2019 to approximately RMB9.38 billion for FY2020, which represented an increase of approximately 7.69%. According to the Annual Report 2020 and the Management, such increase was primarily attributable to (i) increased efforts in marketing and academic promotion such as holding conferences and meetings to introduce and promote the knowledge of the finished drug products (including clinical data and drug application) among doctors and experts in the medical field for key finished drug products and newly launched finished drug products; and (ii) expansion of sales force of finished drugs that the Group established designated sales teams with specific knowledge of newly launched finished drug products.

The administrative expenses increased from approximately RMB748.51 million for FY2019 to approximately RMB945.71 million for FY2020, which represented an increase of approximately 26.35%. According to the Annual Report 2020 and the Management, such increase was primarily attributable to the expanded scale of operation and management function of the Group.

The research and development expenses increased from approximately RMB2.0 billion for FY2019 to approximately RMB2.89 billion for FY2020, which represented an increase of approximately 44.5%. According to the Annual Report 2020 and the Management, such increase was primarily attributable to (i) increased number of products under development; and (ii) increased spending on ongoing and newly initiated clinical trials.

With reference to the Annual Report 2020, there was occurrence of gain on disposal of subsidiaries for approximately RMB314.90 million for FY2020 (FY2019: nil). Based on the above and as the increase of gross profit of the Group for FY2020 exceeded the increase of (i) selling and distribution expenses; (ii) administrative expenses; and (iii) research and development expenses of the Group for FY2020 as mentioned above, the Group recorded increase of profit for the year from approximately RMB3.73 billion for FY2019 to that of approximately RMB5.23 billion for FY2020, which represented an increase of approximately 40.21%. The profit for the year attributable to owners of the Company increased from approximately RMB3.71 billion for FY2019 to that of approximately RMB5.16 billion for FY2020, which represented an increase of approximately 39.08%.

Financial performance for FY2021

The Group recorded a revenue of approximately RMB27.87 billion for FY2021, which represented an increase of approximately 11.75% as compared with that of approximately RMB24.94 billion for FY2020. According to the Annual Report 2021 and the Management, such increase was mainly due to revenue growth from (i) the Finished Drug Business from approximately RMB20.40 billion for FY2020 to approximately RMB22.68 billion for FY2021 mainly attributable to the growth in sales volume of certain existing finished drug products (including drugs for the therapeutic area of oncology) and growth in sales volume generated from the newly launched finished drugs products; and (ii) the Bulk Product Business from approximately RMB3.23 billion for FY2020 to approximately RMB3.82 billion for FY2021 mainly attributable to the growth in sales volume and increase in selling price of vitamin C products and increase in sales volume of antibiotics products.

Due to the increased of revenue of the Group for FY2021, the gross profit of the Group increased from approximately RMB18.69 billion for FY2020 to approximately RMB21.14 billion for FY2021, which represented an increase of approximately 13.11% and the gross profit margin of the Group was approximately 75.84% for FY2021, which is stable as compared to that of approximately 74.91% for FY2020.

The selling and distribution expenses of the Company increased from approximately RMB9.38 billion for FY2020 to approximately RMB10.44 billion for FY2021, which represented an increase of approximately 11.30%. According to the Annual Report 2021 and the Management, such increase was primarily attributable to (i) increased efforts in marketing and academic promotion such as holding conferences and meetings to introduce and promote the knowledge of the finished drug products (including clinical data and drug application) among doctors and experts in the medical field for key finished drug products and newly launched finished drug products; and (ii) expansion of sales force of finished drugs.

The administrative expenses slightly increased from approximately RMB0.95 billion for FY2020 to approximately RMB1.01 billion for FY2021, which represented an increase of approximately 6.32%. According to the Annual Report 2021 and the Management, such increase was primarily attributable to the expanded scale of operation of the Group.

The research and development expenses increased from approximately RMB2.89 billion for FY2020 to approximately RMB3.43 billion for FY2021, which represented an increase of approximately 18.69%. According to the Annual Report 2021 and the Management, such increase was primarily attributable to increased spending on ongoing and newly initiated clinical trials.

As the increase of gross profit of the Group for FY2021 slightly exceeded the increase of (i) selling and distribution expenses; (ii) administrative expenses; and (iii) research and development expenses of the Group for FY2021 as mentioned above, the Group recorded slight increase of profit for the year from approximately RMB5.23 billion for FY2020 to approximately RMB5.69 billion for FY2021, which represented an increase of approximately 8.80%. The profit for the year attributable to owners of the Company increased slightly from approximately RMB5.16 billion for FY2020 to approximately RMB5.61 billion for FY2021, which represented an increase of approximately 8.72%.

Financial performance for FY2022

The Group recorded a revenue of approximately RMB30.94 billion for FY2022, which represented an increase of approximately 11.02% as compared with that of approximately RMB27.87 billion for FY2021. According to the Annual Report 2022 and the Management, such increase was mainly due to increase in revenue generated from (i) Finished Drug Business from approximately RMB22.68 billion for FY2021 to approximately RMB24.52 billion for FY2022 mainly attributable to the growth in sales volume of certain existing finished drug products (including anti-infective and drugs for the therapeutic area of nervous system) and newly launched finished drug products; (ii) Bulk Product Business from approximately RMB3.82 billion for FY2021 to approximately RMB4.45 billion for FY2022 mainly attributable growth in sales volume of vitamin C products and antibiotics products; and (iii) the functional food and others business segment of the Group increased from approximately RMB1.37 billion for FY2021 to approximately RMB1.97 billion for FY2022 mainly attributable to increase in selling price and growth in sales volume of caffeine products.

The gross profit of the Group increased from approximately RMB21.14 billion for FY2021 to approximately RMB22.26 billion for FY2022, which represented an increase of approximately 5.30% and the gross profit margin of the Group decreased from approximately 75.84% for FY2021 to approximately 71.94% for FY2022. According to the Annual Report 2022 and the Management, such decrease was mainly attributable to the decline in selling prices of certain finished drug products and decline in selling prices of vitamin C products, which are key products of Bulk Product Business, due to market competition during the year.

The selling and distribution expenses of the Company decreased slightly from approximately RMB10.44 billion for FY2021 to approximately RMB10.34 billion for FY2022, which represented a slight decrease of approximately 0.96%. According to the Annual Report 2022 and the Management, such decrease was primarily attributable to the Group enhanced the efficiency of the marketing activities.

The administrative expenses increased from approximately RMB1.01 billion for FY2021 to approximately RMB1.17 billion for FY2022, which represented an increase of approximately 15.84%. According to the Annual Report 2022 and the Management, such increase was mainly due to the expanding operation of the Group and employee share-based compensation expense recognised in respect of the share awards granted to selected employees of the Group by Key Honesty Limited (a shareholder of the Company) during FY2022.

The research and development expenses increased from approximately RMB3.43 billion for FY2021 to approximately RMB3.99 billion for FY2022, which represented an increase of approximately 16.33%. According to the Annual Report 2022 and the Management, such increase was primarily attributable to increased spending on ongoing and newly initiated clinical trials.

Based on the above, the Group recorded increase of profit for the year from approximately RMB5.69 billion for FY2021 to approximately RMB6.23 billion for FY2022, which represented an increase of approximately 9.49% and the profit for the year attributable to owners of the Company increased from approximately RMB5.61 billion for FY2021 to approximately RMB6.09 billion for FY2022, which represented an increase of approximately 8.56%.

Financial performance for FP2023

The Group recorded a revenue of approximately RMB16.08 billion for FP2023, which remained stable as compared to that of approximately RMB15.61 billion for the six months ended 30 June 2022 (“**FP2022**”). The gross profit of the Group recorded approximately RMB11.24 billion for FP2023, which was also stable as compared to that of approximately RMB11.34 billion for FP2022. The gross profit margin of the Group remained stable for FP2023 and recorded approximately 69.88%, as compared to that of approximately 72.64% for FP2022.

The selling and distribution expenses of the Company decreased from approximately RMB5.41 billion for FP2022 to approximately RMB4.90 billion for FP2023, which represented a decrease of approximately 9.43%. According to the Interim Report 2023 and the Management, such decrease was primarily attributable to the Group enhanced the efficiency of the marketing activities despite the Group continued to expand its market coverage and actively promote the newly launched finished drug products.

The research and development expenses increased from approximately RMB1.88 billion for FP2022 to approximately RMB2.30 billion for FP2023, which represented an increase of approximately 22.34%. According to the Interim Report 2023 and the Management, such increase was primarily attributable to increased spending on ongoing and newly initiated clinical trials.

As the decrease of selling and distribution expenses of the Group for FP2023 as mentioned above offset the increase of the research and development expenses of the Group for FP2023 as mentioned above, the profit for the period of the Group (FP2022: approximately RMB3.03 billion and FP2023: approximately RMB3.06 billion) and the profit for the period attributable to owners of the Company (FP2022: approximately RMB2.97 billion and FP2023: approximately RMB2.97 billion) both remained stable.

Financial position of the Group as at 31 December 2022 and 30 June 2023

Table 2: Financial position of the Group

	As at 30 June 2023 RMB'000 (unaudited)	As at 31 December 2022 RMB'000 (audited)
Non-current assets	19,291,668	17,812,614
Property, plant and equipment	10,037,227	9,582,060
Right-of-use assets	1,321,356	1,394,859
Investment property	61,085	62,737
Goodwill	234,904	234,904
Intangible assets	2,264,522	1,908,112
Interests in associates	678,042	685,290
Interests in joint ventures	707,227	709,482
Other financial assets	2,532,672	2,125,574
Deferred tax assets	146,351	113,026
Deposits, prepayments and other receivables	568,282	796,570
Bank deposits	740,000	200,000
Current assets	24,381,566	23,957,160
Inventories	2,751,952	2,554,861
Trade receivables	5,415,329	3,937,967
Deposits, prepayments and other receivables	659,499	693,224
Bills receivables	3,006,209	2,602,551
Amounts due from related companies	353,128	195,643
Amounts due from joint ventures	104,759	100,048
Structured bank deposits	1,625,425	3,574,859
Bank deposits, balances and cash	10,465,265	10,298,007
Current liabilities	9,025,669	8,958,000
Trade payables	1,922,553	1,507,986
Other payables	5,780,042	5,355,516
Contract liabilities	233,509	799,458
Bills payables	440,687	502,079
Amounts due to related companies	33,638	104,938
Amounts due to joint ventures	115,518	130,860
Lease liabilities	153,107	142,071
Tax liabilities	291,245	261,608
Bank borrowings	55,370	153,484
Net current assets	15,355,897	14,999,160
Non-current liabilities	1,135,678	1,169,899
Other payables	372,317	270,917
Lease liabilities	186,885	258,039
Deferred tax liabilities	556,576	611,993
Bank borrowings	19,900	28,950
Net assets	33,511,887	31,641,875
Total equity attributable to owners of the Company	31,819,480	30,197,534

As stated in the Interim Report 2023, as at 30 June 2023, current assets of the Group amounted to approximately RMB24.38 billion, which remained stable as compared to that of approximately RMB23.96 billion as at 31 December 2022 and the bank deposits, balances and cash recorded approximately RMB10.47 billion as at 30 June 2023 (approximately RMB10.30 billion as at 31 December 2022).

The non-current assets of the Group increased from approximately RMB17.81 billion as at 31 December 2022 to approximately RMB19.29 billion as at 30 June 2023, mainly due to (i) the property, plant and equipment of the Group increased from approximately RMB9.58 billion as at 31 December 2022 to approximately RMB10.04 billion as at 30 June 2023; (ii) the intangible assets (which consist of (a) development costs internally generated or techniques acquired from third parties for the development of products and production technology; (b) research and development projects acquired through business combination and (c) consideration paid by the Group for obtaining product licenses and patents of drugs or drug candidates according to the Management and Annual Report 2022) increased from approximately RMB1.91 billion as at 31 December 2022 to approximately RMB2.26 billion as at 30 June 2023; and (iii) other financial assets (which consists of unlisted investments in partnerships and funds, listed equity securities and unlisted equity securities) increased from approximately RMB2.13 billion as at 31 December 2022 to approximately RMB2.53 billion as at 30 June 2023.

The current liabilities of the Group recorded approximately RMB9.03 billion as at 30 June 2023, which remained stable as compared to that of approximately RMB8.96 billion as at 31 December 2022. The non-current liabilities of the Group also remained stable (approximately RMB1.17 billion as at 31 December 2022 and approximately RMB1.14 billion as at 30 June 2023).

Based on the above, the net assets of the Group increased slightly from approximately RMB31.64 billion as at 31 December 2022 to approximately RMB33.51 billion as at 30 June 2023. The equity attributable to owners of the Company also increased slightly from approximately RMB30.20 billion as at 31 December 2022 to approximately RMB31.82 billion as at 30 June 2023.

(c) *Industry outlook of the principal business of the Group*

As the Group is principally engaged in manufacture and sales of pharmaceutical products in the PRC, we made reference to the official statistics and policies in the PRC in order to understand the development of the pharmaceutical industry in the PRC. According to the statistics available from the National Bureau of Statistics of China (“**National Bureau**”), set out below are the health expenditure per capita in the PRC in recent years:

Table 3: Health expenditure per capita in the PRC

	2021	2020	2019	2018	2017
Health expenditure per capita (RMB)	5,439.97	5,112.34	4,669.34	4,206.74	3,756.72

Source: National Bureau’s website (data.stats.gov.cn)

As shown in the table above, the health expenditure per capita was in an increasing trend from 2017 to 2021 and increased from approximately RMB3,757 per year in 2017 to approximately RMB5,440 per year in 2021, which represented a compound annual growth rate of approximately 9.70%.

We also made reference to the 14th Five-Year Plan for the Development of the Pharmaceutical Industry (the “**Pharmaceutical Industry Development Plan**”) issued by the PRC official authorities including the National Development and Reform Commission in December 2021 (https://www.gov.cn/zhengce/zhengceku/2022-01/31/content_5671480.htm). According to the Pharmaceutical Industry Development Plan, the PRC official authorities targeted to maintain average annual growth rate of operating income and total profit of the pharmaceutical industry in the PRC remains above 8% during 2021 to 2025. On top of the objectives to strengthen the technology development and encourage the research and development of innovative products within the pharmaceutical industry in the PRC, the Pharmaceutical Industry Development Plan also indicated that PRC official authorities will implement supportive policies such as deduction of research and development expenses and simplified collection of value-added tax on anti-cancer drugs and rare disease drugs.

Based on the abovementioned increasing trend of the health expenditure per capita in the PRC in recent years and the supportive intentions of the PRC official authorities towards the pharmaceutical industry, we are of the view and concur with the Management’s view that the industry outlook of the pharmaceutical industry in the PRC is positive.

2. Principal terms of the Underlying Transaction and grant conditions of the Share Options

(a) Principal terms of the Underlying Transaction

Details of the Underlying Transaction are set out under the paragraph headed “2. GRANT OF SHARE OPTIONS UNDER THE SHARE OPTION SCHEME” in the Board Letter, which are summarised below:

Date of Grant:	4 September 2023
Number of Share Options conditionally granted:	Share Options entitling the holders thereof to subscribe for a total of 50,000,000 Shares, representing approximately 0.420% of the total number of issued Shares immediately before the completion of the Exercise of the Share Options and approximately 0.418% of the total number of issued Shares as enlarged by the issuance of the Share Option Shares, respectively (assuming there is no other change in the number of issued Shares of the Company)
Closing price per Share on the Date of Grant:	HK\$5.98
Consideration of the Share Options:	HK\$1.00 to be paid by each Management Grantee upon acceptance of his respective Share Options
Exercise price of the Share Options:	HK\$5.98 per Share, representing the higher of: (i) the closing price of HK\$5.98 per Share as stated in the Stock Exchange’s daily quotations sheet on the Date of Grant (i.e. the date of the Announcement); and (ii) the average closing price of HK\$5.91 per Share as stated in the Stock Exchange’s daily quotations sheets for the five business days immediately preceding the Date of Grant (i.e. the date of the Announcement).
Exercise period of the Share Options:	Subject to fulfillment of the Grant Conditions, the vesting conditions and vesting period as mentioned below, the Share Options shall be exercisable within a period of 10 years from the Date of Grant (i.e. 4 September 2023 to 3 September 2033, both days inclusive).

Vesting conditions and vesting period of the Share Options:

Vesting of the Share Options are subject to the following conditions:

First Tranche: Conditional upon the Group having achieved a single-digit percentage growth on the amount of the underlying profit attributable to Shareholders (i.e. the profit attributable to Shareholders after excluding certain non-operating items as determined by the Board) for the year ended 31 December 2023 as compared to that for the year ended 31 December 2022, then 50% of the Share Options will be vested on 1 April 2024.

Second Tranche: Conditional upon the Group having achieved a double-digit percentage growth on the amount of the underlying profit attributable to Shareholders (i.e. the profit attributable to Shareholders after excluding certain non-operating items as determined by the Board) for the year ended 31 December 2024 as compared to that for the year ended 31 December 2023, then 50% of the Share Options will be vested on 1 April 2025.

If the condition referred to above in respect of the first tranche or the second tranche cannot be satisfied, the Share Options under the relevant tranche shall not be vested.

The remuneration committee of the Company is of the view that such vesting period is appropriate in the circumstances taking into account that the conditional grant of the Share Options is for the purpose of providing incentives and rewards to the Management Grantees for their continuous contributions to the growth and development of the Group.

Conditions precedent:

The conditions which must be fulfilled before the Exercise of the Share Options are set out in the section headed "Grant Conditions of the Share Options" in the Board Letter. The Grant Conditions cannot be waived by the Company or any of the Management Grantees.

Financial assistance:

The Group has not provided any financial assistance to the Management Grantees to facilitate the purchase of the Share Option Shares upon the Exercise of the Share Options.

Clawback Mechanism:

If a Management Grantee ceases to be an employee, director or executive of any member of the Group (the "**Relevant Company**") by reason of the termination of his employment, directorship or office on the ground that he/she has been guilty of misconduct, or has committed any act of bankruptcy, or has become insolvent, or has made any arrangements or composition with his creditors generally, or has been convicted of any criminal offence involving his integrity or honesty or (if so determined by the Board) on any other ground on which the Relevant Company would be entitled to terminate his employment, directorship or office (whether under law or contract), the Share Options granted to such Management Grantee will lapse automatically and will not be exercisable (to the extent not already exercised).

If a Management Grantee ceases to be a participant of the Share Option Scheme (i) for any reason other than on his death or the termination of his employment, directorship, office or appointment on one or more of the grounds specified in the preceding paragraph above; or (ii) by reason of his death, such Management Grantee (or his personal representative(s) in the case of death) may exercise such Management Grantee's Share Options up to his entitlement at the date of cessation or death (to the extent exercisable but not already exercised) within a period of 3 months and 12 months respectively following the date of cessation or death (as the case may be).

The number of Share Options conditionally granted to each of the Management Grantees is set out below:

Name of Management Grantee	Position in the Company	Number of Share Options Conditionally granted
CAI Dongchen	Chairman and Executive Director	18,000,000
ZHANG Cuilong	Vice-Chairman, Chief Executive Officer and Executive Director	8,000,000
LI Chunlei	Executive Director	6,000,000
WANG Huaiyu	Executive Director	3,000,000
WANG Zhenguo	Executive Director	3,000,000
PAN Weidong	Executive Director	3,000,000
WANG Qingxi	Executive Director	3,000,000
CHAK Kin Man	Executive Director	3,000,000
JIANG Hao	Executive Director	3,000,000
Total		50,000,000

Grant conditions of the Share Options

With reference to the Board Letter, the grant and Exercise of the Share Options are subject to the fulfillment of the following conditions precedent (the “**Grant Conditions**”):

- (i) Mr. Cai’s Share Options being approved by more than 50% of the votes cast by the Shareholders (other than Mr. Cai, Mr. Cai’s Related Persons and the Trustee who are required to abstain from voting under the Listing Rules) at the EGM by way of poll in accordance with Chapter 17 of the Listing Rules;
- (ii) the Whitewash Waiver being granted by the Executive pursuant to Note 1 on dispensations from Rule 26 of the Takeovers Code to the Management Grantees of the obligation to make a mandatory general offer for all the issued Shares and other securities (as defined in Note 4 to Rule 22 of the Takeovers Code) of the Company (if any) not already owned or agreed to be acquired by the Management Group as a result of the allotment and issuance of the Share Option Shares to the Management Grantees and such Whitewash Waiver not having been withdrawn; and
- (iii) the respective resolutions relating to the Underlying Transaction on the one hand, and the Whitewash Waiver on the other hand, being approved by more than 50% and at least 75% respectively, of the votes cast by the Independent Shareholders at the EGM by way of poll.

None of the Grant Conditions set out above can be waived by the Company or any of the Management Grantees. The Management Grantees do not reserve the right to waive any of the Grant Conditions. If any of the Grant Conditions is not fulfilled, the Exercise of the Share Options cannot take place and the grant of Share Options will be cancelled.

(b) Fairness of exercise price of the Share Options

The exercise price of the Share Options of HK\$5.98 per Share, representing the higher of: (i) the closing price of HK\$5.98 per Share as stated in the Stock Exchange’s daily quotations sheet on the Date of Grant (i.e. the date of the Announcement); and (ii) the average closing price of HK\$5.91 per Share as stated in the Stock Exchange’s daily quotations sheets for the five business days immediately preceding the Date of Grant (i.e. the date of the Announcement). According to the Management, the determination of exercise price of the Share Options is in compliance with the requirements of Rule 17.03E of the Listing Rules. As no discount had been provided to the Management Grantees, we are of the view and concur with the Management’s view that the exercise price of the Share Options is fair and reasonable.

(c) *Comparable grant of share options*

In order to evaluate the fairness and reasonableness of the terms of the Underlying Transaction, we have, on a best effort basis, identified an exhaustive list of grant of share options by the companies listed on main board of the Stock Exchange who have similar principal business as the Group during the period from 5 September 2022 to 4 September 2023, being twelve-month period immediately prior to the Date of Grant. Based on the aforesaid criteria, we identified four comparable grants of share options (the “**Comparable Grants**”). We consider that the period under review, being twelve months, is adequate to provide a fair and representative sample for analysis of recent grant of share options to compare with the Underlying Transaction.

Shareholders should note that the Comparable Grants have different market capitalisations as compared to those of the Company and the sizes of the shares to be granted to the participants under the Comparable Grants vary. However, we still consider the Comparable Grants to be fair and representative in assessing the fairness and reasonableness of the terms of the Underlying Transaction, after taking into account that (a) the Comparable Grants were engaged in similar principal business as the Group; and (b) a sufficient number of the Comparable Grants has been identified, which could provide a general reference to the terms of grant of share options. The following table sets out details of the Comparable Grants:

Table 4: Comparable Grants

	Date of grant	Company name (Stock code)	Market capitalisation (HK\$ million) (Note 1)	Principal business	Whether the exercise price is premium/discount over/to the closing price on the date of grant or average closing price for five trading days immediately preceding the date of grant	Vesting conditions relating to the financial performance target of the company
1	13 September 2022	HUTCHMED (China) Limited (13)	20,712	Manufacturing and sale of drugs	No premium or discount and the exercise price is same as the closing price on the date of grant	No

	Date of grant	Company name (Stock code)	Market capitalisation (HK\$ million) (Note 1)	Principal business	Whether the exercise price is premium/discount over/to the closing price on the date of grant or average closing price for five trading days immediately preceding the date of grant	Vesting conditions relating to the financial performance target of the company
2.	2 December 2022	Lee's Pharmaceutical Holdings Limited (950)	781	Development, manufacturing, marketing and sales of pharmaceutical products	No premium or discount and the exercise price is same as the closing price on the date of grant	No
3.	15 December 2022	Zhaoke Ophthalmology Limite (6622)	1,988	Development, manufacturing and marketing of ophthalmic drugs	No premium or discount and the exercise price is same as average closing price for five trading days immediately preceding the date of grant	Yes
4.	3 May 2023	Endurance RP Limited (575)	246	Biopharma and investment businesses	Premium to the closing price on the date of grant and average closing price for five trading days immediately preceding the date of grant (Note 2)	No
	4 September 2023	The Company	70,348	Manufacture and sales of pharmaceutical products	No premium or discount and the exercise price is same as the closing price on the Date of Grant	Yes

Source: the Stock Exchange's website (www.hkex.com.hk)

Notes:

1. Based on the average closing price of the share of the respective Comparable Grant as quoted on the Stock Exchange for the five consecutive trading days prior to the Date of Grant and their respective issued shares as quoted on the published monthly return for August 2023 available on the website of the Stock Exchange.
2. With reference to the announcement of Endurance RP Limited (“Endurance RP”) dated 4 May 2023, the closing price of share on its date of grant (i.e. HK\$0.055) and the average closing price of share on the five business days immediately preceding its date of grant (i.e. HK\$0.056) have been below the nominal value of share (i.e. HK\$0.078), accordingly the exercise price of the share options represented the nominal value of share of Endurance RP and we consider it as outlier.

As shown in the table above, except one Comparable Grant as outlier (please refer to note 2 to the above table for reasons), all of the Comparable Grants determined the exercise price in compliance with the requirements of Rule 17.03E of the Listing Rules and provide no discounts or premiums to respective grantees, which is same as the Underlying Transaction and only one out of four Comparable Grants has vesting conditions relating to the performance target of its future financial performance. Accordingly, we are of the view that the terms of the Underlying Transaction are fair and reasonable.

3. Information of the Management Grantees

As stated in the Board Letter, the Management Grantees are the chairman, Directors, chief executives and/or substantial shareholder of members of the Group. We have reviewed the information furnished by the Management regarding the background and working experience of the Management Grantees and noted that their expertise and experience would continuously contribute to the business development of the Group. Details of the Management Grantees are set out below:

According to the Directors’ report of the Annual Report 2022, Mr. Cai, the chairman of the Company, has been an executive Director of the Company since April 1997. He ceased to be the chief executive officer of the Company on 27 May 2022. Mr. Cai is also the chairman of the nomination committee and a director of certain subsidiaries of the Company. Mr. Cai holds a master of business administration degree from Nankai University and has extensive technical and management experience in the pharmaceutical industry. Mr. Cai is a substantial shareholder of the Company. Mr. Cai is also a director of True Ally Holdings Limited and Massive Giant Group Limited, both are substantial shareholders of the Company.

Based on the information provided by Management, Mr. Cai is responsible for formulating the business strategies and long-term development plan and goals of the Group. He provides leadership and guidance to the Board in executing business plans and achieving the Company’s objectives. Mr. Cai identifies key areas in both business development and risk aspects that require the attention of the Board, ensuring that these issues are effectively addressed. Additionally, he serves as a representative of the Company, actively fostering and strengthening relationships with external parties and within the pharmaceutical industry.

According to the Directors' report of the Annual Report 2022, Mr. Zhang Cuilong ("**Mr. Zhang**"), being the vice-chairman of the Company, has been an executive director of the Company since July 2018. He was appointed as the chief executive officer of the Company on 27 May 2022. Before this appointment, Mr. Zhang was the rotating chief executive officer of the Company. Mr. Zhang is also a director of certain subsidiaries of the Company. Mr. Zhang holds a bachelor's degree in pharmacology from Hebei Medical College (now known as Hebei Medical University) and has extensive technical, marketing and management experience in the pharmaceutical industry.

Based on the information provided by the Management, Mr. Zhang is responsible for formulating the business strategies of the Group, building the senior management team of the Group, managing organisational structure and system of the Group and communicating with the Board. Additionally, he is responsible for overseeing the Group's day-to-day operations to ensure the execution of the business plan. Mr. Zhang closely collaborates with the Group's Management team to make operational decisions aimed at achieving the Group's objectives, improving efficiency and enhancing risk management. Furthermore, he serves as a representative of the Company, actively fostering and strengthening relationships with external parties and within the pharmaceutical industry.

According to the Directors' report of the Annual Report 2022, Dr. Li Chunlei ("**Dr. Li**"), has been an executive Director of the Company since December 2017. Dr. Li is currently the chief scientist of the Group and in charge of research and development. Dr. Li is also a director of certain subsidiaries of the Company, deputy director of the Novel Pharmaceutical Preparations and Excipients State Key Laboratory and director of the Hebei Pharmaceutical Engineering Technology Centre. Dr. Li holds a bachelor's degree in engineering (biological pharmaceuticals) from Jilin University and Shenyang Pharmaceutical University, a master's degree in science (microbial and biochemical pharmaceuticals) from Jilin University and a doctorate in science (pharmaceutical science) from Shenyang Pharmaceutical University.

Based on the information provided by the Management, Dr. Li is the chief scientist of the Group, leading the research and development department. He is responsible for developing and sustaining the Group's research and development capabilities. Dr. Li achieves this by nurturing talent, advancing technology, and enhancing the pipeline of projects. In his role, Dr. Li manages a team of scientists and supporting staff to ensure the successful implementation of research and development plans. He oversees research studies and drives the development of new technologies to enhance the Group's research and development capabilities. Dr. Li also sets research and development priorities and identifies product candidates with promising clinical and market value. Furthermore, Dr. Li is responsible for overseeing the pre-clinical and clinical development of product candidates, as well as regulatory submissions. He also oversees intellectual property protection and patent applications for the Group.

According to the Directors' report of the Annual Report 2022, Mr. Wang Huaiyu ("**Mr. Wang**") has been an executive Director of the Company since October 2010. Mr. Wang is also a director of certain subsidiaries of the Company. Mr. Wang holds a bachelor's degree in microbiology and biochemistry from Hebei University and has extensive technical and management experience in the pharmaceutical industry.

Based on the information provided by the Management, Mr. Wang assumes a leadership role in the Bulk Product Business of the Group. His responsibilities include developing both short and long-term business plans for this division. Mr. Wang formulates and executes sales strategies that are aligned with the Company's overall business goals and responsible for the day-to-day management of the sales team. He ensures that the sales and marketing strategies are effectively implemented to achieve the business plans and sales targets. Furthermore, Mr. Wang oversees and manages the manufacturing of the bulk drug products. His role is to ensure that the production processes are aligned with the sales plans and that the products are manufactured at a competitive production cost.

According to the Directors' report of the Annual Report 2022, Mr. Wang Zhenguo, has been an executive Director of the Company since January 2012. Mr. Wang Zhenguo is also a director of certain subsidiaries of the Company. Mr. Wang Zhenguo holds a bachelor's degree in chemistry from Nankai University and has extensive technical, marketing and management experience in the pharmaceutical industry.

Based on the information provided by the Management, Mr. Wang Zhenguo assumes a leadership role of the Finished Drug Business. His responsibilities include developing business plans and objectives for Finished Drug Business. Furthermore, he is responsible for building and maintaining the Group's product commercialisation capabilities. This involves ensuring effective strategies are in place to successfully bring products to market and generate revenue for the Group. In addition, he manages a professional sales team, with a particular focus on innovative drugs. He takes on the day-to-day management of the sales team by formulating and executing sales strategies that align with the Company's overall business goals, aiming to drive sales growth and market penetration.

According to Directors' report of the Annual Report 2022, Mr. Pan Weidong ("**Mr. Pan**") has been an executive Director of the Company since October 2006. Mr. Pan is also a director of certain subsidiaries of the Company. Mr. Pan holds an executive master of business administration degree from Tsinghua University and has extensive finance, accounting and investment experience in the pharmaceutical industry. Mr. Pan is a director of Common Success International Limited, a substantial shareholder of the Company.

Based on the information provided by the Management, Mr. Pan oversees the capital and financing activities within the Group. His primary responsibility is to optimise the financial resources and capital structure of the Company to support operational activities, growth initiatives, and financial obligations. Additionally, Mr. Pan oversees the finance and accounting function of the Group, ensuring that a high standard of financial management is maintained, encompassing areas such as financial reporting, budgeting, cash management, and internal controls. By upholding these standards, Mr. Pan contributes to the overall financial health and stability of the Group. Moreover, Mr. Pan is responsible for long-term financial planning, aligning it with the business goals of the Company. Furthermore, Mr. Pan holds the position of chairman in an A-share listed subsidiary of the Company. In this role, he leads and manages the development and operation of the functional food segment of the Group.

According to the Directors' report of the Annual Report 2022, Dr. Wang Qingxi ("**Dr. Wang**"), has been an executive Director of the Company since August 2018. Dr. Wang is also a director of certain subsidiaries of the Company. Prior to joining the Group, Dr. Wang worked at Merck & Co., Inc. in the United States (the "U.S.") for 20 years where he held senior positions including director of pharmaceutical research and development and director of business development and operation. Dr. Wang holds a bachelor's degree in science (chemistry) and a master's degree in science (chemistry) from Nankai University in China, a master's degree in science (polymer science) and a doctorate in chemistry from University of Connecticut in the U.S. and a master of business administration degree from Temple University in the U.S.

Based on the information provided by the Management, Dr. Wang is responsible for the oversight and management of the research and development centers of the Group ("**US Centers**") in the U.S., ensuring their effective operation and alignment with the Group's objectives. Dr. Wang manages a team of scientists and supporting staff within the US Centers. His role is to ensure the successful implementation of research and development plans in the US Centers by setting research and development priorities, identifying areas of focus and potential product candidates that hold clinical and market value. In addition, Dr. Wang oversees the pre-clinical and clinical development of product candidates, as well as the regulatory submission process. Dr. Wang is also responsible for overseeing the intellectual property protection and patent applications for the Group. Dr. Wang plays a significant role in overseeing the Group's business development efforts in the U.S. market. This includes collaborating with overseas partners through licensing agreements, both in terms of licensing products into the Group and licensing products out to overseas partners.

According to the Directors' report of the Annual Report 2022, Mr. Chak Kin Man ("**Mr. Chak**") has been an executive Director of the Company since December 2005. Mr. Chak is also a director of certain subsidiaries of the Company. Mr. Chak is an associate member of the Hong Kong Institute of Certified Public Accountants and a fellow member of the Association of Chartered Certified Accountants. Mr. Chak holds a bachelor of social sciences degree from The University of Hong Kong and has extensive experience in finance, accounting and investor relations. Mr. Chak is a director of Common Success International Limited, a substantial shareholder of the Company.

Based on the information provided by the Management, Mr. Chak oversees the operations in Hong Kong. His responsibilities include external financial reporting, treasury management, corporate compliance (including compliance with Listing Rules), environmental social and governance reporting, corporate governance reporting, investor relations and developing the investor relations plan and strategy. He serves as the principal contact person with the company secretary and maintains effective communication with independent non-executive Directors. Mr. Chak's expertise contributes to financial transparency, regulatory compliance, and strong investor relationships of the Group.

According to the Directors' report of the Annual Report 2022, Dr. Jiang Hao ("**Dr. Jiang**"), has been an executive Director of the Company since November 2020. Prior to joining the Group in August 2020, Dr. Jiang has worked at Fastenal Company as general manager (northern and central China) in the U.S., Tianjin Kesun Technology Company (marketing and sales center of Baidu, Inc. in Tianjin) as general manager and 3H Health Investment Management Ltd. as assistant to chairman and chief operation officer. Dr. Jiang holds a bachelor's degree in management from Hebei University of Technology, a master's degree in management, economics and industrial engineering from Politecnico di Milano and a doctorate in management (technology economics and management) from Hebei University of Technology.

Based on the information provided by the Management, Dr. Jiang primarily focused on the business development of the Group. Dr. Jiang would identify potential opportunities for license-in, license-out, and mergers and acquisitions that align with the Group's development strategies. Dr. Jiang leads a team of business development staff who are responsible for evaluating and managing the execution of deals. Furthermore, Dr. Jiang oversees the sale and marketing of certain finished drug products in the county-level market and certain centralised-procurement finished drug products in China and is also responsible for overseeing the investor relations function including the development of investor relations plan and strategy.

As per the discussion with the Management and considering the above, we understand that the Management Grantees have been crucial to the business development and operation of the Group. We are of the view and concur with the Management's view that leveraging the expertise, experience and knowledge of the Management Grantees is in the best interests of the Group for its future development. Therefore, it is important for the Group to retain and motivate the Management Grantees through the Underlying Transaction.

4. Reasons and benefit of the Underlying Transaction

As stated in the Board Letter, the Underlying Transaction, which allows the Management Grantees to gain further ownership interest in the Group and ties more closely their personal interest directly with the value of the Group, would incentivise and motivate the Management Grantees for their continuous commitment, devotion and contributions to the development and growth of the Group going forward. In addition, in light of the satisfactory financial performance of the Group for FY2020, FY2021 and FY2022, if the vesting conditions and the Granting Conditions of the Share Options are fulfilled, the Exercise of the Share Options by the Management Grantees as a reward, compensation and remuneration to the Management Grantees in recognition of their valuable contributions to the Group is justifiable. Furthermore, upon completion of the Exercise of the Share Options, it will result in positive cash flows of approximately HK\$299.0 million derived from the exercise price payable by the Management Grantees to the Company which in turn will further replenish the Company's general working capital for its business operations and developments.

As advised by the Management, given the highly competitive industry in which the Group operates, replacing executive officers or key employees in the pharmaceutical industry may be difficult and may take a prolonged period of time to attract experts with the breadth of expertise and experience required to successfully develop, gain regulatory approval of, manufacture and commercialise drug products. Maintaining a stable and experienced management team is therefore critical to the development and expansion of pharmaceutical companies. In particular, according to the Management, as at the Latest Practicable Date, there were over 50 product candidates of the Group in clinical stage pursuing toward market approvals in a broad range of indications, any replacement in the key executives may adversely affect the clinical development progress and product commercialisation. Given that the Share Options to be granted are subject to the vesting conditions of at least after the financial results of the Group for the year ending 31 December 2023 (“FY2023”) and 2024 (“FY2024”) to be published (with vesting conditions on growth of profits of the Group as stated below), we consider that such feature is designed to motivate the Management Grantees continuing commitment and contribution towards the development of the Group with their expertise and experience, and thereby promote the development of the Group.

With reference to the Board Letter, the vesting of the Share Options are subject to a single-digit percentage growth on the amount of the underlying profit attributable to Shareholders (i.e. the profit attributable to Shareholders after excluding certain non-operating items as determined by the Board) for the FY2023 and that of a double-digit percentage for FY2024. Accordingly, we are of the view and concur with the Management’s view that the Underlying Transaction would incentivise the Management Grantees to strive for higher profits of the Group in the near future which is fair and reasonable and in the interests of the Group and the Independent Shareholders as a whole.

As discussed with the Management, the Board has considered several methods of providing incentives to the Management Grantees, including lump sum cash bonuses as well as share bonuses and share awards under the share award scheme of the Company. After careful consideration of the various alternatives, although the Group recorded strong bank balances and cash of approximately RMB10.47 billion as at 30 June 2023, the Board considers that granting of Share Options is the most appropriate and in the best interest of the Group given that, as opposed to the other alternatives, granting of Share Options will enable the Group to conserve its cash resources carry on its current business operation of the Group which including business development, expenditure in research and development (research and development expenses of approximately RMB3.43 billion for FY2021 and approximately RMB3.99 billion for FY2022 according to Annual Report 2022) and sufficient buffer cash for future or sudden use while allowing added incentives to the Management Grantees.

Having considered that (i) the Underlying Transaction, which allows the Management Grantees to gain further ownership interest in the Group and ties more closely their personal interest directly with the value of the Group, would incentivise and motivate the Management Grantees for their continuous commitment, devotion and contributions to the development and growth of the Group going forward; (ii) maintaining a stable and experienced management team is critical to the development and expansion of the Group and the Underlying Transaction is designed to motivate the Management Grantees continuing commitment and contribution towards the development of the Group; (iii) based on the vesting conditions on growth of profits of the Group, the Underlying Transaction would incentivise Management Grantees to strive for higher profits of the Group in the near future; and (iv) granting of Share Options will enable the Group to conserve its cash resources to carry on its current business and sufficient buffer cash for future or sudden use while allowing added incentives to the Management Grantees, we are of the view that the Underlying Transaction is fair and reasonable and in the interests of the Company and the Independent Shareholders as a whole.

5. Potential dilution effects of the Underlying Transaction

With reference to the paragraph headed “3. EFFECTS ON SHAREHOLDING STRUCTURE OF THE COMPANY” in the Board Letter, subject to the Grant Conditions having been fulfilled and assuming that there will be no change in the total number of issued Shares during the period from the Latest Practicable Date up to completion of the Exercise of the Share Options, upon the Exercise of the Share Options at the exercise price of HK\$5.98 per Share as prescribed in the terms of the grant, the Management Grantees will be allotted and issued with an aggregate of 50,000,000 new Shares, representing approximately 0.420% of the total number of issued Shares immediately before the completion of the Exercise of the Share Options and approximately 0.418% of the total number of issued Shares as enlarged by the issuance of the Share Option Shares, respectively.

As at the Latest Practicable Date, there were (i) 11,903,219,732 Shares in issue; (ii) 50,000,000 outstanding Share Options as disclosed in the Board Letter; and (iii) 658,000 outstanding share awards (being existing Shares held by the Trustee which have not yet been vested) and 4,000 share awards (being existing Shares held by the Trustee which have been vested but not yet been transferred to the relevant awardee) pursuant to the Share Award Scheme. Save as disclosed above, as at the Latest Practicable Date, the Company had no other outstanding securities convertible or exchangeable into Shares.

The Management Group holds an aggregate of 3,558,899,663 Shares, representing approximately 29.90% of the total number of issued Shares as at the Latest Practicable Date.

The following table sets out the shareholding structure of the Company (i) as at the Latest Practicable Date; and (ii) immediately after the issuance of the Share Option Shares upon Exercise of the Share Options (assuming that there will be no other change in the total number of issued Shares prior to completion of the Exercise of the Share Options):

	As at the Latest Practicable Date		Immediately after the issuance of the Share Option Shares upon Exercise of the Share Options	
	No. of Shares	%	No. of Shares	%
I. Management Group				
Mr. Cai and Mr. Cai's Controlled Corporations (Note 1)	2,826,255,670	23.74	2,844,255,670	23.79
Common Success (Note 2)	728,796,313	6.12	728,796,313	6.10
Mr. ZHANG Cuilong	–	–	8,000,000	0.07
Dr. LI Chunlei	–	–	6,000,000	0.05
Mr. WANG Huaiyu	–	–	3,000,000	0.03
Mr. WANG Zhenguo	–	–	3,000,000	0.03
Mr. PAN Weidong	–	–	3,000,000	0.03
Dr. WANG Qingxi (Note 3)	–	–	3,000,000	0.03
Mr. CHAK Kin Man	3,847,680	0.03	6,847,680	0.06
Dr. JIANG Hao	–	–	3,000,000	0.03
Sub-total of the Management Group:	3,558,899,663	29.90	3,608,899,663	30.19
II. Other Shareholders				
Other Shareholders	8,344,320,069	70.10	8,344,320,069	69.81
Total	11,903,219,732	100.0	11,953,219,732	100.0

Notes:

- As at the Latest Practicable Date, Mr. Cai was beneficially interested in 225,386,960 Shares and was deemed to be interested in 2,600,868,710 shares through various companies, comprising (i) 406,904,640 Shares (representing approximately 3.42% of the total number of issued Shares) directly held by Key Honesty, a direct wholly-owned subsidiary of True Ally, (ii) 1,218,834,470 Shares (representing approximately 10.24% of the total number of issued Shares) directly held by Massive Giant, a direct wholly-owned subsidiary of True Ally, (iii) 948,249,600 Shares (representing approximately 7.97% of the total number of issued Shares) directly held by True Ally, which is directly wholly-owned by Mr. Cai and (iv) 26,880,000 Shares (representing approximately 0.23% of the total number of issued Shares) directly held by Harmonic Choice by virtue of his interests in a chain of corporations holding Harmonic Choice, namely Massive Top, of which March Rise, Beijing Zhongyihe and True Ally owns 75%, 15% and 10%, respectively. March Rise in turn is owned as to 40% by True Ally and 60% by Beijing Zhongyihe, the general partner of which is Mr. Cai.

2. As at the Latest Practicable Date, Common Success was ultimately beneficially owned by more than 80 individuals being existing and former management personnel of (i) the Group and (ii) CSPC Holdings Group. These management personnel include certain Directors, namely Mr. Zhang Cui long, Mr. Pan Weidong, Mr. Wang Zhenguo, Mr. Wang Huaiyu, Dr. Li Chunlei and Dr. Jiang Hao. None of these Directors beneficially own one-third or more of the total number of issued shares of Common Success.
3. Based on the information provided by Key Honesty, Key Honesty granted share awards to Dr. Wang Qingxi, enabling him to acquire 3,000,000 Shares from Key Honesty at the consideration of HK\$2.95 per Share pursuant to a share grant agreement dated 1 April 2022 made between Key Honesty and Dr. Wang Qingxi. Such share awards will only be vested in batches after 3 years from 1 April 2022 subject to the terms of the aforesaid share grant agreement.
4. Certain figures included in the above table have been subject to rounding adjustments. Accordingly, figures shown as totals or sub-totals may not represent precise arithmetic aggregations.

As illustrated above, the aggregate shareholding of the other public Shareholders will decrease from approximately 70.10% to approximately 69.81% after the issuance of the Share Option Shares upon Exercise of the Share Options. Having considered the reasons and benefits of granting the Share Options, which has been mentioned in the above paragraph headed “Reasons and benefit of the Underlying Transaction”, we therefore consider that the dilution effect on the percentage shareholding of existing Shareholders in the Company as a result of the issuance of the Share Option Shares upon Exercise of the Share Options is justifiable.

6. Application for Whitewash Waiver

As at the Latest Practicable Date, the Management Group held an aggregate of 3,558,899,663 Shares, representing approximately 29.90% of the total number of issued Shares as at the Latest Practicable Date. Upon completion of the Exercise of the Share Options, the Management Group will be interested in 3,608,899,663 Shares, representing (a) approximately 30.32% of the total number of issued Shares as at the Latest Practicable Date; and (b) approximately 30.19% of the total number of issued Shares as enlarged by the issuance of the Share Option Shares.

The Exercise of the Share Options in full will cause the aggregate shareholding interests in the total number of issued Shares held by the Management Group to increase from approximately 29.90% (of the total number of issued Shares as at the Latest Practicable Date) to approximately 30.19% (of the total number of issued Shares as enlarged by the issuance of the Share Option Shares). Accordingly, the Management Grantees would be obliged to make a mandatory general offer pursuant to Rule 26.1 of the Takeovers Code to the Shareholders for all the issued Shares of the Company not already owned or agreed to be acquired by the Management Group as a result of the allotment and issuance of the Share Option Shares to the Management Grantees, unless the Whitewash Waiver is granted by the Executive.

In this regard, an application has been made to the Executive for the Whitewash Waiver pursuant to Note 1 on dispensations from Rule 26 of the Takeovers Code. The Whitewash Waiver, if granted by the Executive, will be subject to, among other things, the conditions that the respective resolutions relating to the Underlying Transaction on the one hand, and the Whitewash Waiver on the other hand, being approved by more than 50% and at least 75% respectively, of the votes cast by the Independent Shareholders at the EGM by way of poll in accordance with the requirements of the Takeovers Code.

The Executive has agreed, subject to the respective resolutions relating to the Underlying Transaction on the one hand, and the Whitewash Waiver on the other hand, being approved by more than 50% and at least 75% respectively, of the votes cast by the Independent Shareholders at the EGM by way of poll, to waive the obligation of the Management Grantees to make a mandatory general offer as a result of the allotment and issuance of the Share Options Shares to the Management Grantees by the Company.

To consider whether the granting of the Whitewash Waiver is in the interests of the Company and Independent Shareholders as a whole and is fair and reasonable so far as the Independent Shareholders are concerned, we have taken into account the benefits that the Exercise of the Share Options will bring to the Group as stated in the section headed “4. Reasons and benefit of the Underlying Transaction” above in this letter, and the fact that the Exercise of the Share Options is conditional upon the granting of the Whitewash Waiver by the Executive and the Independent Shareholders having approved the Whitewash Waiver at the EGM and such conditions cannot be waived.

Based on our analysis regarding the terms of the Underlying Transaction, we consider that the Underlying Transaction, the Whitewash Waiver and the transactions contemplated thereunder are in the interests of the Company and the Independent Shareholders as a whole and are fair and reasonable so far as the Independent Shareholders are concerned.

7. Financial effect of the Underlying Transaction

As advised by the Management, save for the expenses in relation to the issue and allotment of the Share Option Shares, the grant of Share Options will not have any material impact on the Group’s cash position and net current assets.

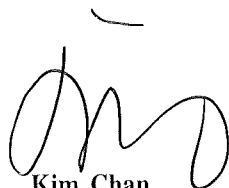
RECOMMENDATION

Although the aggregate shareholding of the other public Shareholders will decrease from approximately 70.10% to approximately 69.81% after the issuance of the Share Option Shares upon Exercise of the Share Options, having taken into account the principal factors and reasons as discussed above in this letter, and in summary as follows (which should be read in conjunction with and interpreted in the full context of this letter):

- (i). except one Comparable Grant as outlier, all of the Comparable Grants determined the exercise price in compliance with the requirements of Rule 17.03E of the Listing Rules and provide no discounts or premiums to respective grantees, which is same as the Underlying Transaction and only one out of four Comparable Grants has vesting conditions relating to the performance target of its future financial performance as stated under the paragraph headed “2. Principal terms of the Underlying Transaction and grant conditions of the Share Options” above in this letter;
- (ii). leveraging the expertise, experience and knowledge of the Management Grantees is in the best interests of the Group for its future development and it is important for the Group to retain and motivate the Management Grantees through the Underlying Transaction as stated under the paragraph headed “3. Information of the Management Grantees” above in this letter;
- (iii). based on the vesting conditions on growth of profits of the Group, the Underlying Transaction would incentivise Management Grantees to strive for higher profits of the Group in the near future as stated under the paragraph headed “4. Reasons and benefit of the Underlying Transaction” above in this letter; and
- (iv). granting of Share Options will enable the Group to conserve its cash resources to carry on its current business and sufficient buffer cash for future or sudden use while allowing added incentives to the Management Grantees as stated under the paragraph headed “4. Reasons and benefit of the Underlying Transaction” above in this letter,

we consider that the Underlying Transaction, the Whitewash Waiver and the transactions contemplated thereunder are on normal commercial terms which are fair and reasonable so far as the Independent Shareholders are concerned and are in the interests of the Company and the Independent Shareholders as a whole. We therefore advise the Independent Board Committee to recommend, and ourselves recommend, the Independent Shareholders to vote in favor of the relevant resolutions to be proposed at the EGM for approving the Underlying Transaction, the Whitewash Waiver and the transactions contemplated thereunder.

Yours faithfully,
For and on behalf of
Nuada Limited



Kim Chan
Director



Kevin Wong
Vice President

Mr. Kim Chan is a person licensed to carry out type 6 (advising on corporate finance) regulated activity under the SFO and is a responsible officer of Nuada Limited who has over 18 years of experience in corporate finance industry.

Mr. Kevin Wong is a person licensed to carry out type 6 (advising on corporate finance) regulated activity under the SFO and is a responsible officer of Nuada Limited who has over 16 years of experience in corporate finance industry.